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No. 82-2091

IN THE
Supreme Court of the United States
OCTOBER TERM, 1982

SHEARN MOODY, JR.,
Petitioner,

v.

DAVID C. MEYERS, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE, AND BRIEF OF AMICUS CURIAE, CITIZENS ECONOMIC FOUNDATION

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August 19, 1983

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MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE, CITIZENS ECONOMIC FOUNDATION

The Citizens Economic Foundation, hereby moves this Court pursuant to Supreme Court Rules 36.1 and 42.2(b), for leave to file the annexed Brief of Amicus Curiae in support of the Petition for Writ of Certiorari in this case.

Amicus Citizens Economic Foundation is a non-profit, section 501(c)(3) tax-exempt corporation organized and existing under the laws of Texas.

As stated in its Articles of Incorporation, Citizens Economic Foundation is "dedicated to research and analysis of economic and fiscal policy and their effects on the well-being of individuals and society and the education of the general public thereto." It believes that the issues presented by Petitioner have profound economic and fiscal

implications affecting American society, especially the relationships between business and government. Amicus Curiae is therefore highly interested in the issues presented by the Petitioner.

Accordingly, Amicus respectfully requests that it be permitted to state its views on the merits of the Petition. Amicus will show that the decision of the Fifth Circuit in this case is in error in applying Texas rather than Alabama law and believes further that the Alabama law properly applicable to this action is more favorable to Defendant-Appellant than the Texas law applied by the panel. Authorities and policy arguments not contained in the Petition, but relevant to the issues presented therein, will be discussed.

Respectfully submitted,

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TABLE OF CONTENTS

	Page
Table of Authorities	ii
Statement	1
Interest of Amicus Curiae	1
Summary of Argument	1
Argument	2
I. THE FIFTH CIRCUIT COURT COMMITTED CLEAR ERROR IN APPLYING TEXAS RATHER THAN ALABAMA LAW; AND THE ALABAMA LAW APPLICABLE TO THIS ACTION WOULD BE MORE FAVORABLE TO DEFENDANT-APPELLANT THAN THE TEXAS LAW APPLIED BY THE COURT	2
A. The Court Was Required To Follow Texas Conflicts Of Laws Principles In Effect At The Time Of Its Decision In Deciding Which State's Law Would Apply	2
B. Under Current Texas Conflict Of Laws Principles, Texas Courts Would Apply Alabama Law In The Circumstances Of This Case	5
C. The Alabama Law Properly Applicable To This Action Is More Favorable To Defendant-Appellant Than The Texas Law Applied By The Court	7
Conclusion	10

TABLE OF AUTHORITIES

CASES: Page

Blythe v. *Enslen*, 203 Ala. 692, 85 So. 1 (1919).... 9
Bradley v. *Richmond School Board*, 418 U.S. 696 (1974) 3
City of Gadsen v. *Harbin*, 398 So. 2d 707 (Ala. Civ. App. 1981) 9
Click v. *Thuron Indus., Inc.*, 460 S.W. 2d 506 (Tex. Civ. App. 1970) 8
Day & Zimmerman, Inc. v. *Challoner*, 423 U.S. 3 (1975) 2
Deal v. *Johnson*, 362 So.2d 214 (Ala. 1978) 8
Emmert v. *Drake*, 224 F.2d 299 (5th Cir. 1955).... 8
Fagan v. *La Gloria Oil & Gas Co.*, 494 S.W.2d 624 (Tex. Civ. App., no writ)..... 8
Francis v. *Herrin Transportation Co.*, 423 S.W. 2d 610 (Tex. Civ. App. 1968) 8
Garrett v. *Raytheon Co.*, 368 So.2d 516 (Ala. 1979) 9
Gulf Offshore Co. v. *Mobile Oil Corp.*, 453 U.S. 473 (1981) 3
Gutierrez v. *Collins*, 583 S.W.2d 312 (Tex. 1979).... 4
Houston Lighting & Power Co. v. *Dickinson Indep. School Dist.*, 641 S.W.2d 302 (Tex. Ct. App. 1982) 3
Houston North Hospital Properties v. *Telco Leasing*, 688 F.2d 408 (5th Cir. 1982) 2, 4, 10
Jump v. *Goldenhersh*, 474 F. Supp. 1306 (E.D. Mo. 1979), *aff'd*, 619 F.2d 11 (8th Cir. 1980)..... 5, 6
King v. *Livingston Mfg. Co.*, 68 S. 897, 192 Ala. 269 (1915)..... 8
Klaxon Co. v. *Stentor Electric Manufacturing Co.*, 313 U.S. 487 (1941)..... 2
Lovell v. *Smith*, 232 Ala. 626, 169 So. 280 (1936).. 9
Manchester Premium Budget Corp. v. *Manchester Insurance & Indemnity Co.*, 612 F.2d 398 (8th Cir. 1980) 5
Nations v. *Sun Oil Co.*, 695 F.2d 933, slip op. at 1986 (5th Cir., January 20, 1983) 3
Robertson v. *McKnight*, 609 S.W. 2d 534 (Tex. 1981) 4

TABLE OF AUTHORITIES—Continued

	Page
Sellers v. *Head*, 73 So.2d 747, 261 Ala. 212 (1954)	8
Shaffer v. *Heitner*, 433 U.S. 186, 214 n.44 (1977)	5
Sutton v. *Reagan & Gee*, 405 S.W. 2d 828 (Tex. Civ. App., Writ ref'd n.r.e.)	8
United States v. *Schooner Peggy*, 5 U.S. (1 Cranch) 103 (1801)	3
Van Antwerp Realty Corp. v. *Cooke*, 162 So. 97, 230 Ala. 535 (1935)	8
STATUTES AND REGULATIONS:	
Alabama Code § 6-2-39 (5)	9
Texas Business Corporation Act	2
Texas Insurance Code	2
MISCELLANEOUS:	
Restatement (Second) of Conflict of Laws:	
Section 6	6
Section 142(2)	8
Section 143	8
Section 145	6
Section 309	5

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BRIEF OF AMICUS CURIAE, CITIZENS ECONOMIC FOUNDATION

STATEMENT

Amicus Curiae adopts the statement of Petitioner. Pet. 2-6.

INTEREST OF AMICUS

The interest of Amicus Curiae is set forth in the foregoing Motion.

SUMMARY OF ARGUMENT

Amicus believes that because of a change in Texas conflict of laws principles subsequent to the trial, the Fifth Circuit Court committed clear error in applying Texas rather than Alabama law and believes further that the

Alabama law properly applicable to this section is more favorable to Defendant-Appellant than the Texas law applied by the panel. Only last year, the Fifth Circuit Court granted a petition for rehearing to consider the effects of a change in Texas Conflict rules. *Houston North Hospital Properties* v. *Telco Leasing*, 688 F.2d 408 (5th Cir. 1982). Amicus believes that *Houston North Hospital Properties* case controls this case and requires this Court to grant rehearing to consider whether Alabama law applies, and to consider what impact application of Alabama law would have on the case.

ARGUMENT

I. THE FIFTH CIRCUIT COMMITTED CLEAR ERROR IN APPLYING TEXAS RATHER THAN ALABAMA LAW; AND THE ALABAMA LAW APPLICABLE TO THIS ACTION WOULD BE MORE FAVORABLE TO DEFENDANT-APPELLANT THAN THE TEXAS LAW APPLIED BY THE COURT

A. The Court Was Required To Follow Texas Conflict Of Laws Principles In Effect At The Time Of Its Decision In Deciding Which State's Law Would Apply

The Fifth Circuit Court acknowledged that it was required to follow Texas conflict of laws principles, Panel Op. at 1457, citing *Klaxon Co.* v. *Stentor Electric Manufacturing Co.*, 313 U.S. 487 (1941), but it completely failed to do so. Instead, the Court simply assumed that Texas law applied, and then determined that the Texas Business Corporation Act rather than the Texas Insurance Code provided the applicable legal standard. Panel Op. at 1458.[1]

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[1] *Compare Day & Zimmerman, Inc.* v. *Challoner*, 423 U.S. 3 (1975) (per curiam), summarily reversing a decision of the Fifth Circuit Court which declined to apply Texas conflict of laws rules in a diversity case arising out of the Eastern District of Texas. According to the Supreme Court (*id.* at 4-5):

Had the Court focused on Texas conflict of laws principles it would have discovered that while this case was pending on appeal, Texas dramatically changed its conflicts principles, and under those changed principles, Texas courts would have applied Alabama law in the circumstances of this case. Apparently, this change in Texas conflict of laws principle was unknown not only to the Court, but also to the parties.

An appellate court is required to apply the law in effect on the date it renders its decision, not the law in effect at the time of trial. *Bradley* v. *Richmond School Board*, 418 U.S. 696, 711 (1974); *United States* v. *Schooner Peggy*, 5 U.S. (1 Cranch) 103 (1801); *Nations* v. *Sun Oil Co.*, 695 F.2d 933, slip op. at 1986 (5th Cir., January 20, 1983). This principle is fully applicable when the law in effect has been established by judicial decision rather than by legislative enactment. *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473, 486 n.16 (1981). The principle has been accepted by Texas courts as a matter of law. *See Houston Lighting & Power Co.* v. *Dickinson Indep. School Dist.*, 641 S.W.2d 302 (Tex. Ct. App. 1982). Thus, even if the trial court was correct, under the old Texas conflict of laws principles, in applying law, the Court was required to determine whether the subsequent change in Texas conflict of laws principles would compel a different result.

At the time of trial, Texas applied the rule of *lex loci delicto* to determine choice of law in tort cases. Under that rule the applicable law is the law of the state where the last act necessary to complete the tort occurred.

"the conflict-of-laws rules to be applied by a federal court in Texas must conform to those prevailing in the Texas state courts. A federal court in a diversity case is not free to engraft exceptions or modifications which may commend themselves to the federal court, but which have not commended themselves to the State in which the federal court sits. The Court of Appeals in this case should identify and follow the Texas conflicts rules."

Amicus believes that even under that old rule, Alabama law should apply. But it is unnecessary to resolve that question because after the trial Texas changed its conflicts rule. In 1979, the Texas Supreme Court abandoned the old *lex loci* approach and adopted instead the "most significant relationship" test set forth in the Restatement (Second) of Conflict of Laws. *Gutierrez* v. *Collins*, 583 S.W.2d 312 (Tex. 1979). *See also Robertson* v. *McKnight*, 609 S.W.2d 534 (Tex. 1981). Neither the Fifth Circuit Court nor the trial court has had an opportunity to consider whether the new Texas conflict of laws rule would compel application of Alabama law. That is not a purely abstract inquiry because, as *amicus* will show in Point C, Alabama law is more favorable to Defendant-Appellant than is Texas law.

Controlling, in this regard, is the Fifth Circuit Court's recent decision in *Houston North Hospital Properties* v. *Telco Leasing*, 688 F.2d 408 (5th Cir. 1982). This was a diversity case, arising out of a federal district court in Texas, in which a threshold issue was whether Illinois or Texas law applied. The panel, in its initial decision, looked to Texas conflict of laws rules and concluded that Texas would apply the *lex loci* rule to determine the applicable law. 680 F.2d 19, 21 (5th Cir. 1982). The Court granted a petition for rehearing, however, when made aware that the Texas Supreme Court, in *Gutierrez*, *supra*, had abandoned the *lex loci* rule and had adopted the "most significant relationship" test. On rehearing, the panel considered which state's law would apply under the new Texas conflict of laws rule. *Amicus* submits that *Houston North Hospital Properties* is controlling on the facts of the present case, and repairs that this Court grant the petition for Certiorari.

B. Under Current Texas Conflict Of Laws Principles, Texas Courts Would Apply Alabama Law In The Circumstances Of This Case

As noted, subsequent to the trial of this action, Texas adopted the "most significant relationship" test codified in the Restatement (Second) of Conflict of Laws. Under that test Texas courts would apply Alabama law. The Restatement creates a presumption that the law of the *state of incorporation* governs the rights and duties of corporate officers and directors. Section 309 states that

> "The local law of the state of incorporation will be applied to determine the existence and extent of a director's or officer's liability to the corporation, its creditors and shareholders, except where, with respect to a particular issue, some other state law has a more significant relationship under the principles stated in § 6 to the parties and the transaction, in which event the local law of the other state will be applied."

Comment a to § 309 states that "[l]iability will typically be imposed upon directors under the rule of this Section for such matters as the fraudulent or negligent mismanagement of the Corporation's affairs."[2] Because Empire was at all times relevant to this lawsuit an Alabama corporation, the new Texas conflict rules presumptively apply the law of Alabama to determine liability of directors for corporate mismanagement.[3]

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[2] *See Shaffer* v. *Heitner*, 433 U.S. 186, 214 n.44 (1977) ("[i]n general, the law of the state of incorporation is held to govern the liabilities of officers and directors of the corporation to its stockholders. See Restatement § 309. . . . The rationale for the general rule appears to be based . . . on the need for a uniform and certain standard to govern the internal affairs of a corporation. . . .").

[3] Other courts applying the Restatement approach to cases involving insurance companies in liquidation agree that the applicable law is that of the state where the insurance company is incorporated. *See, e.g., Manchester Premium Budget Corp.* v. *Manchester Insurance & Indemnity Co.*, 612 F.2d 389, 391-92 n.8 (8th Cir. 1980); *Jump* v. *Goldenhersh*, 474 F. Supp. 1306 (E.D. Mo. 1979), *aff'd*, 619 F.2d 11 (8th Cir. 1980). The district court in *Jump* v.

Moreover, even aside from the presumptive applicability of Alabama law resulting from the fact that Empire was incorporated in Alabama, it is clear that Alabama has the most significant relationship with the issues in this action, as defined in Restatement §§ 6 and 145.[4] Although Empire's principal headquarters were in

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Goldenhersh, supra, noted that it was particularly important to apply the law of the state of incorporation in such cases:

> "Insurance liquidation cases do not follow the same conflicts of law doctrine which applies to contract or tort cases. According to Missouri conflicts of law doctrine for insurance cases, the substantive law of the state of incorporation and domicile should be applied, even if most of the events in this case happened in Missouri. Most states have found it wise to follow this doctrine because insurance companies have traditionally been self-regulated, rather than being subjected to the Federal Bankruptcy Act . . . and the state laws form a delicately balanced network designed to protect all creditors of an insurance equally, regardless of the state of their residence."

474 F. Supp. at 1313.

[4] Section 6 provides:

> "(1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.
>
> (2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include
>
> (a) the needs of the interstate and the international system,
>
> (b) the relevant policies of the forum;
>
> (c) the relevant policies of other interested states and the relative interest of those states in the determination of the particular issue;
>
> (d) the protection of justified expectations;
>
> (e) the basic policies underlying the particular field of law;
>
> (f) certainty, predictability, and uniformity of result; and
>
> (g) ease in the determination and application of the law to be applied."

Section 145 provides:

> "(1) The rights and liabilities of the parties with respect to an issue of tort are determined by the local law of the state

Texas, it was an Alabama insurance company. The increased value of the life interest was submitted to the Alabama Superintendent of Insurance for approval, and Empire's acquisition and expansion program involved the merger of various other companies into an Alabama corporation. Alabama clearly has a greater interest than Texas in regulating the affairs of an Alabama insurance company, especially in a suit brought by a receiver appointed by an Alabama court pursuant to an Alabama statute. Application of Alabama law, the state of incorporation, would yield more predictable and uniform results than would application of the law of a state, such as Texas, where a company merely does business. And application of Alabama law appears best suited to protect justified expectations.

C. The Alabama Law Properly Applicable To This Action Is More Favorable To Defendant-Appellant Than The Texas Law Applied By The Court

The Fifth Circuit Court applied the Texas law of mismanagement and fiduciary responsibility. The Court described the requirements of Texas law as follows:

> "Texas law imposes on corporate officers and directors a duty to exercise due care in the manage-

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which, with respect to that issue, has the most significant relationship to the occurrence and parties under the principles stated in section 6.

(2) Contacts to be taken into account in applying the principles of section 6 to determine the law applicable to an issue include:

(a) the place where the injury occurred;

(b) the place where the conduct causing the injury occurred;

(c) the domicile, residence, nationality, place of incorporation and place of business of the parties; and

(d) the place where the relationship, if any, between the parties is centered.

These contacts are to be evaluated according to their relative importance with respect to the particular issue."

> ment of the corporation's affairs. If they breach that duty, they are liable to the corporation for any loss it may suffer as a result of their neglect. . . . 'Due care' is that degree of care which a person of ordinary prudence would exercise under the same or similar circumstances."

Panel Op. at 1458. The Court determined, therefore, that Texas imposes liability on corporate officers and directors for their *negligent* actions.[5]

Alabama law, however, does *not* impose liability for negligence. Instead, officers and directors are liable only for losses to the corporation resulting from their willful and intentional departures from duty, fraudulent breaches of trust, gross negligence, or ultra vires acts, and are not liable if they act in good faith and without gross negligence supporting an imputation of fraud. *Deal* v. *Johnson*, 362 So.2d 214 (Ala. 1978); *Van Antwerp Realty Corp.* v. *Cooke*, 162 So. 97, 230 Ala. 535 (1935); *Sellers* v. *Head*, 73 So.2d 747, 261 Ala. 212 (1954); *King* v. *Livingston Mfg. Co.*, 68 So. 897, 192 Ala. 269 (1915). Accordingly, the standard of director liability under Alabama law is considerably more favorable to Defendant-Appellant than is the analogous rule under Texas law.

Moreover, because the Court did not apply the substantive law of Alabama, it did not consider whether the Alabama statute of limitations applies to this case.[6] The

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[5] This interpretation is fully supported by the relevant precedents. *See Sutton* v. *Reagan & Gee*, 405 S.W.2d 828 (Tex. Civ. App., writ ref'd n.r.e.); *Fagan* v. *La Gloria Oil & Gas Co.*, 494 S.W.2d 624 (Tex. Civ. App., no writ); *Emmert* v. *Drake*, 224 F.2d 299 (5th Cir. 1955).

[6] Although statutes of limitations are sometimes considered "procedural", they may also be treated as substantive limitations on the underlying right of action. *Cf. Click* v. *Thuron Indus., Inc.*, 460 S.W.2d 506 (Tex. Civ. App. 1970); *Francis* v. *Herrin Transportation Co.*, 423 S.W.2d 610 (Tex. Civ. App. 1968); Restatement (Second) of Conflict of Laws §§ 142(2), 143. Because this Court applied Texas substantive law, it did not consider whether the appli-

Fifth Circuit Court applied the Texas statute of limitations, which provides for a *two* year period of limitations after the "fraud" is "discovered" or with reasonable diligence should have been discovered.[7] The relevant Alabama statute of limitations provides for a *one* year period of limitations,[8] and since Alabama has expressly rejected the "discovery" rule, the one year period begins to run when the events which form the basis of the tort occurred, whether or not those events were known or discovered at that time.[9]

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cable Alabama statute of limitations was substantive or procedural for purposes of the Texas conflict of laws rules.

[7] Actually, the *state* law claims (either under Texas law or Alabama law) were *not* based on fraud, but on mismanagement or breach of fiduciary duty, and it therefore seems inappropriate to apply the Texas "discovery" rule, or any other special rule that applies only in "fraud" cases.

[8] Alabama Code § 6-2-39(5). This one year period applies to actions for negligence of corporation directors in performing their duties. *Blythe* v. *Enslen*, 203 Ala. 692, 85 So. 1 (1919).

[9] In *Garrett* v. *Raytheon Co.*, 368 So.2d 516 (Ala. 1979), the Alabama Supreme Court held that a claim for exposure to radiation was time-barred even though the plaintiff did not discover the injury until the limitations period had expired. The court recognized the trend in other states towards accepting the discovery rule, but stated that the rule "has been specifically rejected by Alabama courts for the past 60 years." *Id.* at 521. The court said that

> "It may be that Alabama's rejection of the 'Discovery Rule' is contrary to the weight of opinion generally. However, as this Court is committed to the proposition that the legislature has the *inherent power* to establish statutes of limitation, we have no other alternative than to leave it to the legislature to abrogate this rule and adopt a more equitable one should it see fit, so that a plaintiff's claim will not be barred when he has no way to ascertain that he has been damaged . . . because the result has not manifested itself until the statute of limitations has run."

Id. (emphasis in original). *See also City of Gadsen* v. *Harbin*, 398 So.2d 707 (Ala. Civ. App. 1981); *Lovell* v. *Smith*, 232 Ala. 626, 169 So. 280 (1936).

As the Fifth Circuit Court noted, "the events which form the basis of Receiver's state and federal claims occurred more than three years before this suit was commenced." Panel Op. at 1455. Thus, because Alabama rejects the discovery rule, and has a one year period of limitations, this action would be barred under Alabama law.

CONCLUSION

In summary, it is understandable that the Fifth Circuit Court did not apply the new Texas conflict of laws principles, because the change in Texas law occurred after the trial and was apparently unknown to the Court or to the parties. Nevertheless, as the Court ruled in *Houston North Hospital Properties*, in those circumstances an appellate court should grant a petition for rehearing and, on rehearing, apply the Texas conflict of laws rule in effect at the time of its decision. Because of the change in Texas law, neither the trial court nor the Fifth Circuit Court has had an opportunity to consider whether Texas law would now require application of Alabama law, and if so, whether the judgment can be sustained under Alabama law. These questions are important not only to Defendant-Appellant, but also to Alabama, to Texas, and to all lawyers and litigants faced with conflict of laws issues.

Accordingly, this Court should grant the petition of Certiorari.

Respectfully submitted,

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